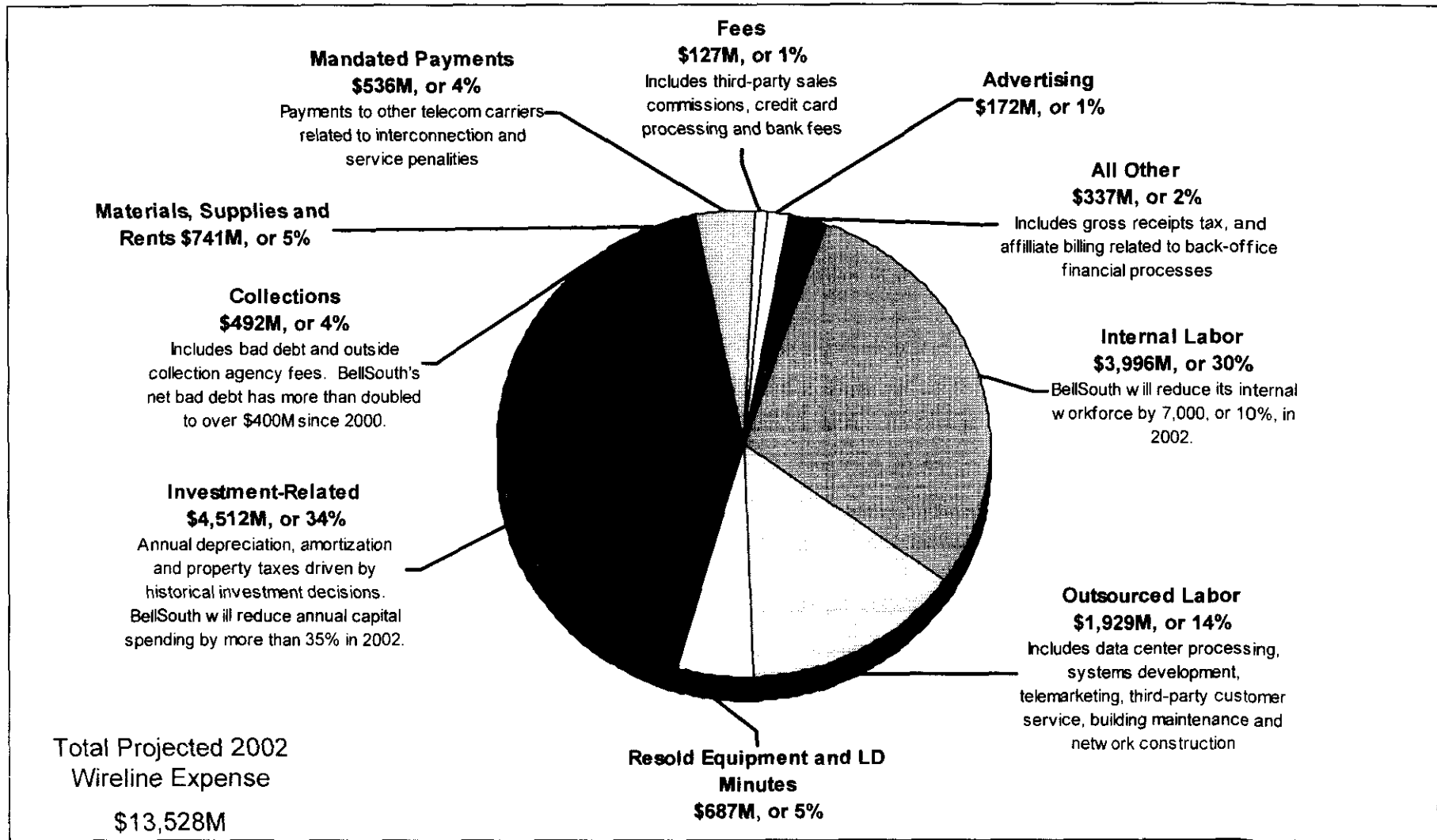


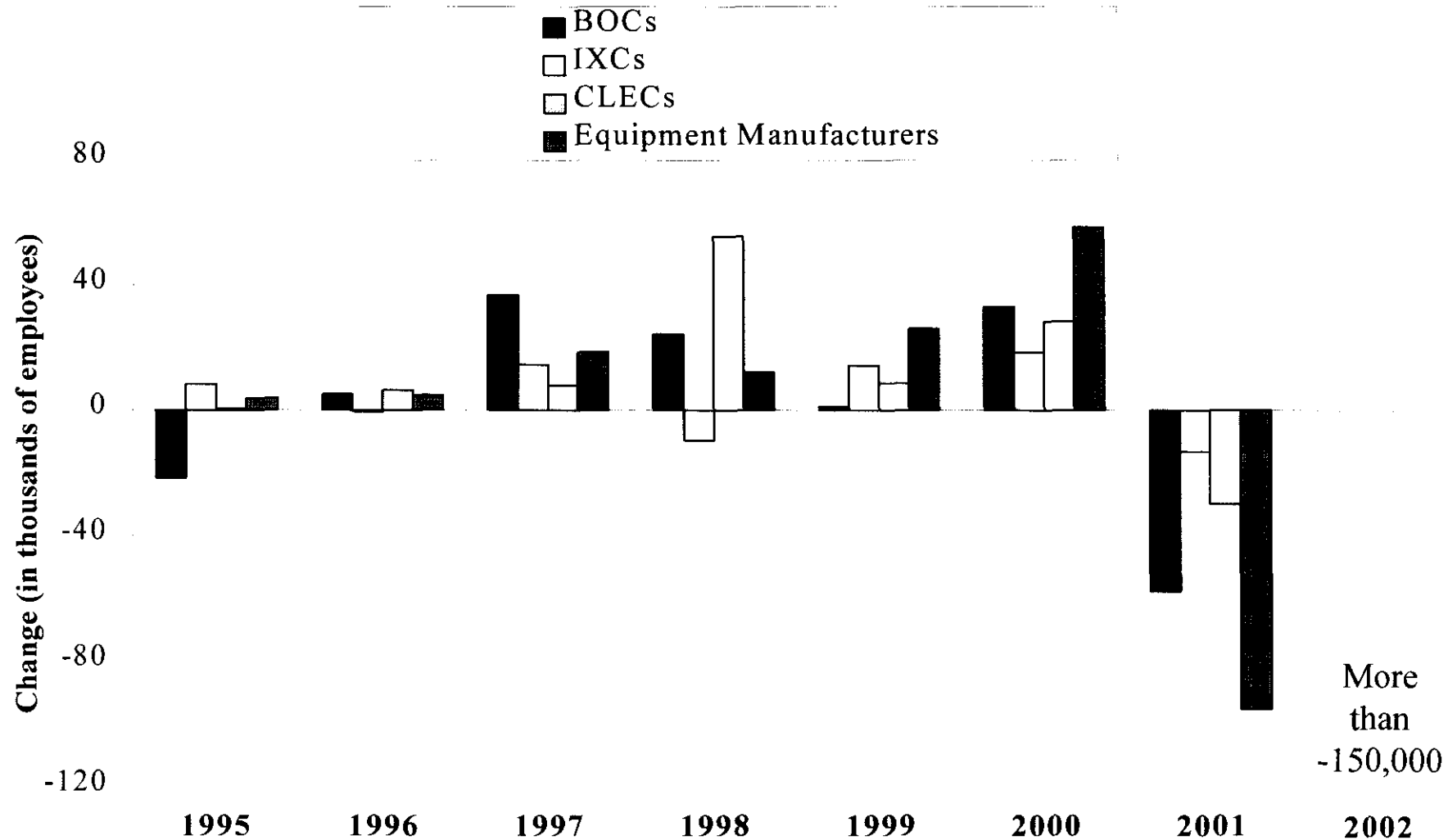
## Proposed Solutions – Cost Structure

- BellSouth must insure the integrity of its balance sheet. With Labor and investment-related cost representing 44% and 34% of BellSouth's annual expense, respectively, few levers are available to offset the effects of declining revenues and margins.



## Proposed Solution - Cost Structure

Telecom Employment 1995-2002

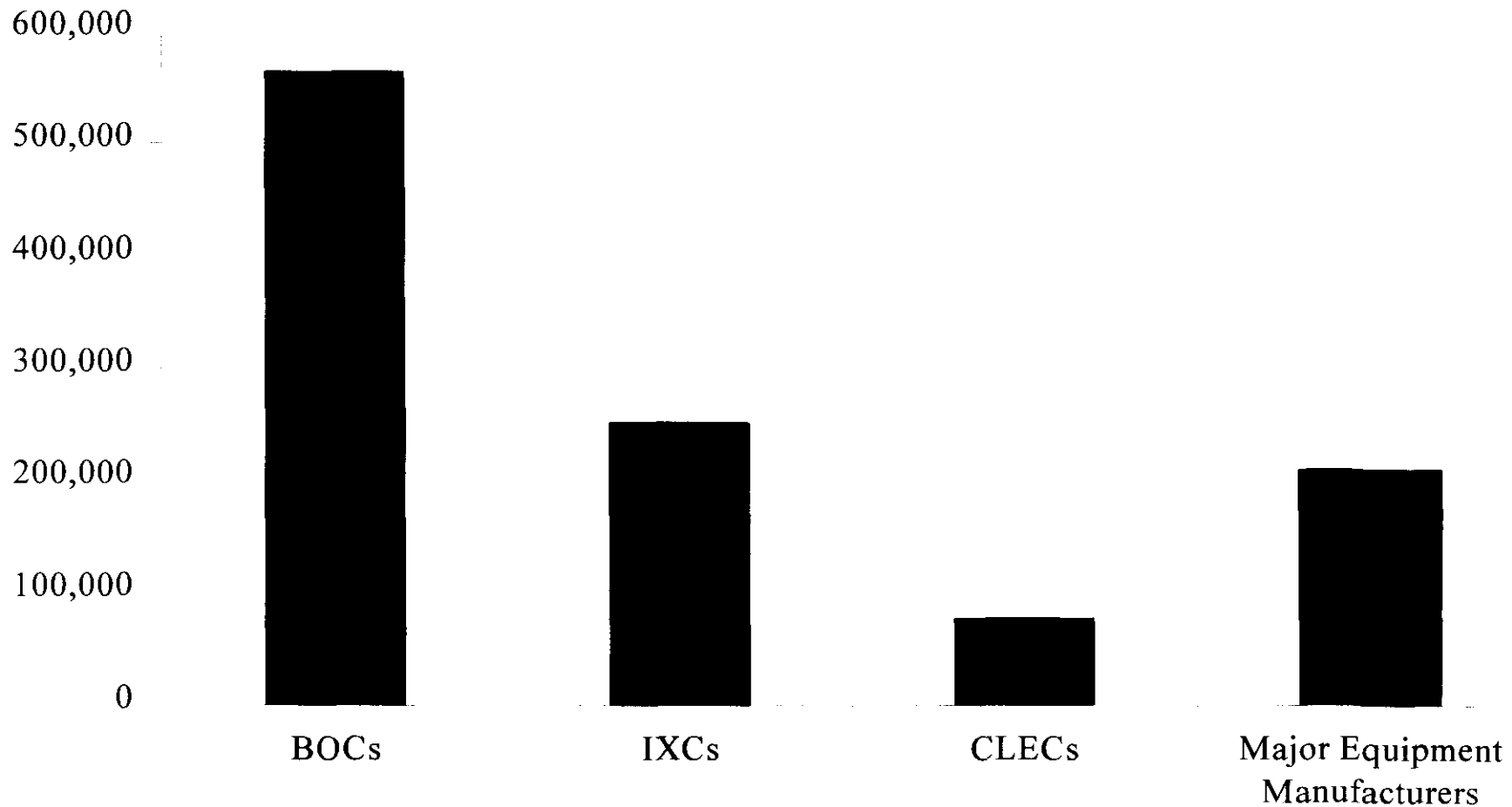


Sources: 1995-2001. Company reports and press releases; Investext analyst reports; news articles. 2002. L. Uchitelle, *Job Cuts Take Heavy Toll on Telecom Industry*, N.Y. Times (June 29, 2002); WorldCom Press Release, *WorldCom Announces Intention to Restate 2001 and First Quarter 2002 Financial Statements* (June 25, 2002).

## ***Proposed Solution - Cost Structure***

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### **Current Jobs Left in Telecom**

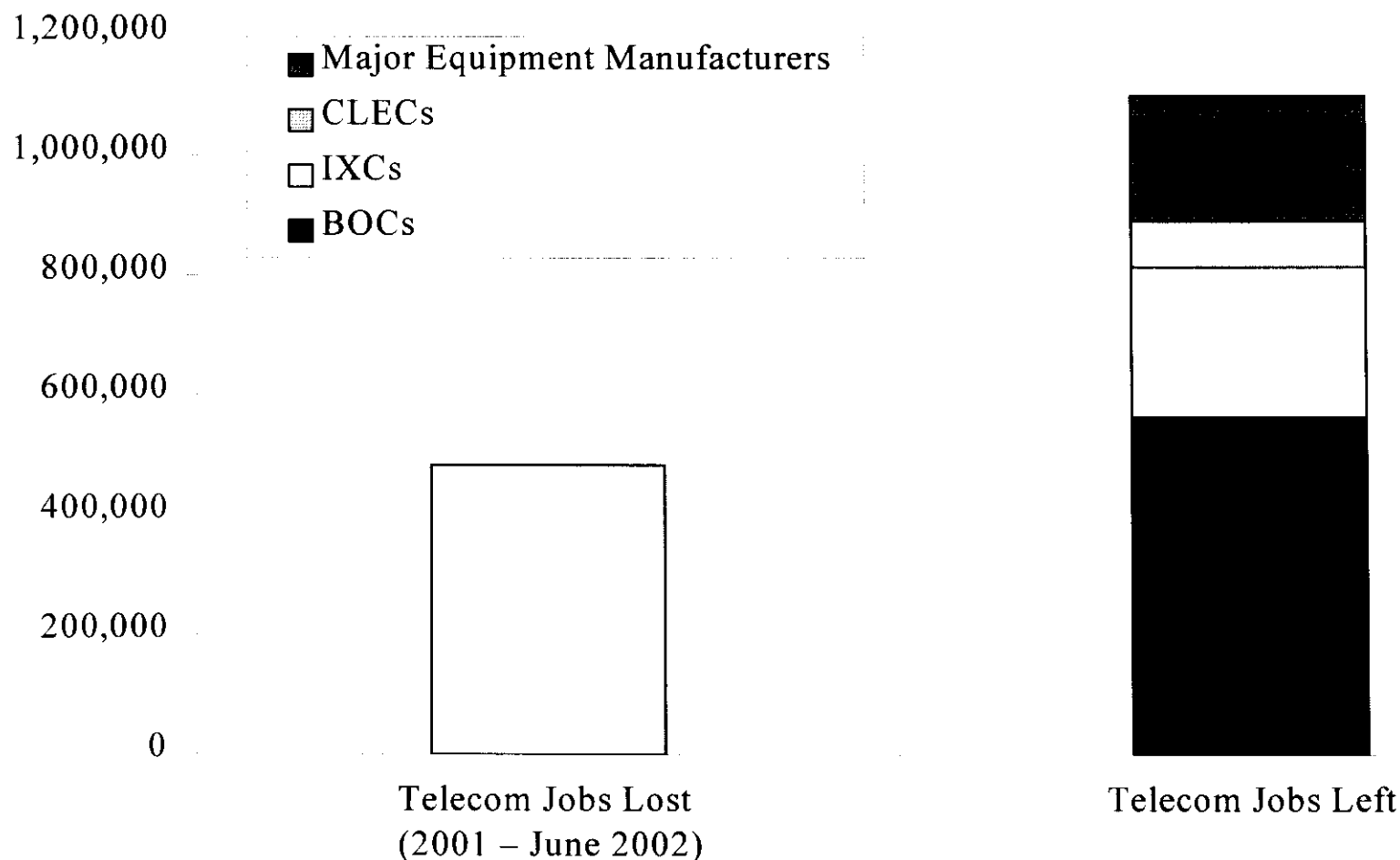


IXCs include AT&T, WorldCom, and Sprint. CLECs do not include AT&T, WorldCom, or ALLTEL.

Sources: Company reports and press releases; L. Uchitelle, *Job Cuts Take Heavy Toll on Telecom Industry*, N.Y. Times at C1 (June 29, 2002); ALTS, *The State of Local Competition 2002* at 8 (Apr. 2002).

# Proposed Solution Cost-Structure

## Current Jobs Left in Telecom



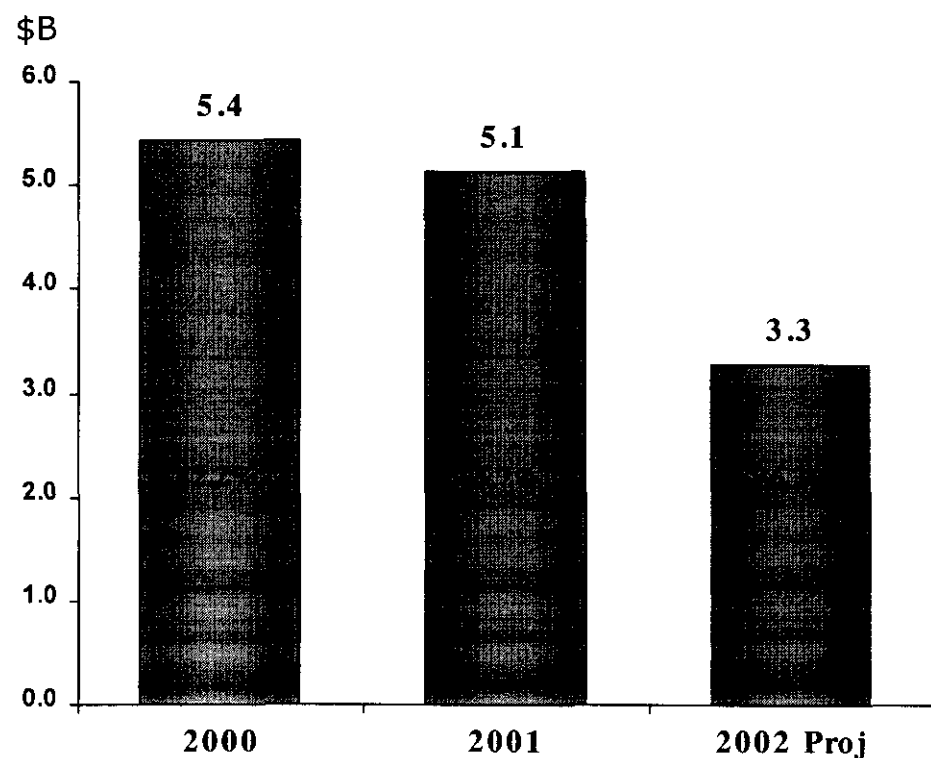
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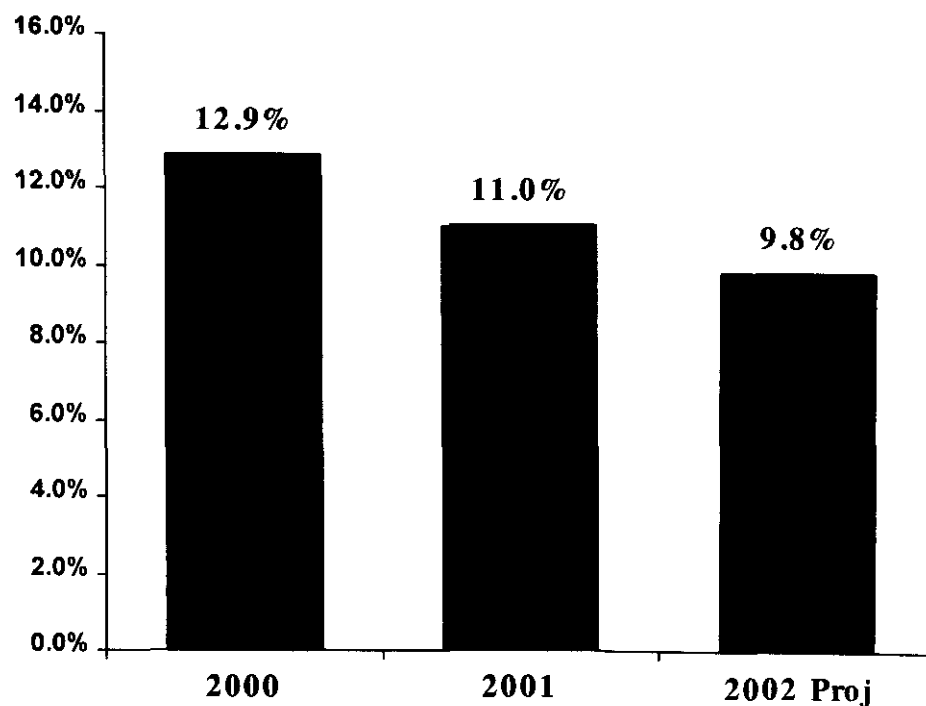
## *Proposed Solutions – Cost Structure*

- Declining revenues have placed substantial pressure on capital spending and innovation in order to attempt to sustain asset returns and strengthen the balance sheet.

Annual Capital Spending



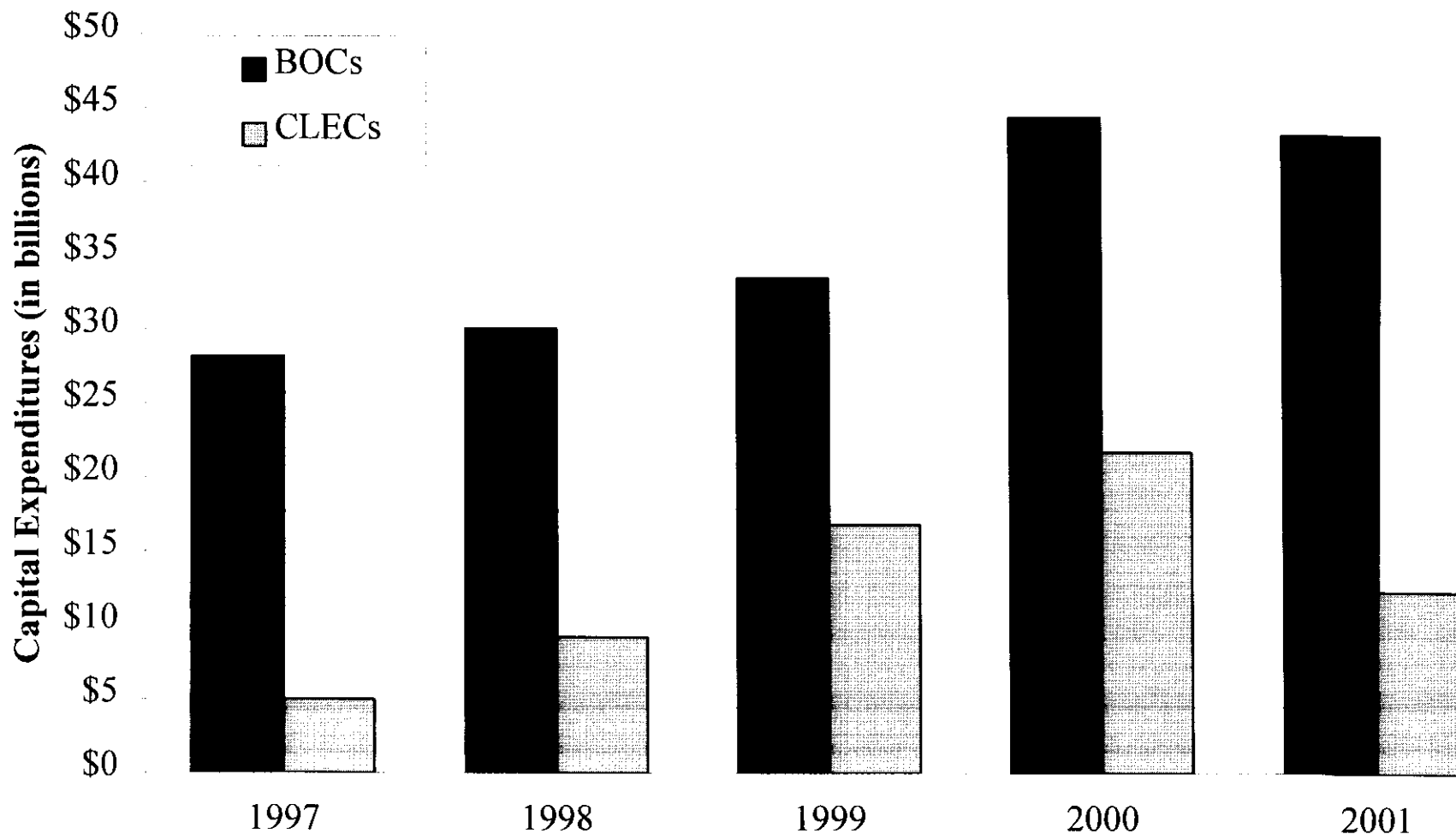
Return on Assets



## *Proposed Solutions – Cost Structure*

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### Capital Expenditures



Sources: BOC company reports; Association for Local Telecommunications Services, *The State of Local Competition 2002* (Apr. 2002) at 11 (CLEC capital expenditures through 3Q 2001 and projected 4Q 2001 expenditures).

## Proposed Solutions – Cost Structure

- The Telecom industry has demonstrated that heavy debt does not mix well with anemic growth – over 80 companies have filed for bankruptcy protection since January 2000.

### Ten Largest Bankruptcy Filings in Telecom (\$ bn)

Company	Date	Assets	Company	Date	Assets
1 WorldCom	7/21/02	\$107.0	6 Metromedia Fiber Network	5/20/02	\$7.0
2 Global Crossing	1/28/02	25.5	7 360Networks	6/28/01	6.3
3 Adelphia Communications	6/25/02	24.4	8 Exodus Communications	9/26/01	6.0
4 NTL	5/8/02	16.8	9 Williams Communications	4/22/02	6.0
5 XO Communications	6/17/02	9.1	10 McLeodUSA	1/30/02	4.8

### Other Bankruptcies

Company	Date	Company	Date	Company	Date	Company	Date
Adelphia Business Solutions	3/27/02	FLAG Telecom Holdings	4/12/02	Mpower Holding	4/8/02	SSE Telecom	5/17/01
Adesta Communications	11/2/01	FutureOne	3/29/01	NEON Communications	6/25/02	Star Telecommunications	3/13/01
Advanced Radio Telecom	4/20/01	General Datacomm Industries	11/2/01	Net2000 Communications	11/16/01	StarBand Communications	5/31/02
Advanced Telcom Group	5/2/02	Global Telesystems	11/14/01	NetVoice Technologies	10/17/01	Startec Global Communications	12/14/01
Ahead Communications Systems	2/7/02	Globalstar	2/15/02	Network Plus	2/4/02	Telecom Consultants	2/23/01
American Metrocomm	8/16/00	Grapes Communications	4/16/02	NorthPoint Communications	1/16/01	Telelobe Holdings	5/15/02
Anicom	1/5/01	GRG	8/7/01	Novo Networks	7/30/01	Teligent Communications	5/21/01
Arch Wireless	12/6/01	GST Telecommunications	5/17/00	Orbcomm Global	9/15/00	Telscape International	4/27/01
At Home Corp. (Excite@Home)	9/29/01	iBEAM Broadcasting	10/11/01	Pacific Gateway Exchange	12/29/00	U.S. Wireless	8/29/01
Birch Telecom	7/29/02	ICG Communications	11/14/00	Paging Network (PageNet)	7/24/00	Ursus Telecom	4/6/01
BroadLink Wireless	6/25/02	IMPSAT Fiber Networks	6/11/02	Pathnet Telecommunications	4/2/01	Verado Holdings	2/15/02
Century Communications	6/10/02	Information Management Associates	7/24/00	Pensat	10/9/01	Versatel Telecom International	6/19/02
Clariti Telecommunications Int'l	4/18/02	International FiberCom	2/13/02	Pinnacle Holdings	5/21/02	Viatel	5/2/01
Convergent Communications	4/19/01	ITC DeltaCom	6/25/02	Pliant Systems	5/1/01	Wavve Telecommunications	8/15/01
Covad Communications	8/15/01	Lemout & Hauspie Speech Products	11/29/00	PNI Technologies	6/8/01	WebLink Wireless	5/23/01
Digital Broadband Communications	12/27/00	Let's Talk Cellular & Wireless	5/30/00	PNV	12/20/00	Western Integrated Networks (WINfirst)	3/11/02
DTI Holdings	12/31/01	Log on America	7/12/02	PSINet	5/31/01	Winstar Communications	4/18/01
e:spire Communications	3/22/01	Logix Communications Enterprises	2/28/02	qServe Communications	6/21/02	World Access	4/24/01
eGlobe	4/18/01	MarchFirst	4/30/01	Rhythms NetConnections	8/1/01	Yipes Communications	3/21/02
EqualNet Communications	8/9/00	Metrolcall	6/3/02	RSL Communications	3/19/01	ZeroPlus.com	2/14/02

Source: Bloomberg, Thomson Financial, BankruptcyData.Com.

1. Excluding private companies and companies with pre-bankruptcy assets under \$100 mm.

## ***Proposed Solution – Cost Structure***

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- "Bankruptcy law effectively rewards and subsidizes market failure by deleting debt and allowing capacity to come back at irrational prices that solvent companies structures cannot match." [Precursor Group, 6/21/02]

	<u>Before</u>	<u>After</u>	<u>% Change</u>
<b><u>Covad</u></b>			
<i>Filed: Aug-01   Emerged: Dec-01</i>			
Total Indebtedness:	\$1,338M	\$50M	-96%
Annual Interest Expense:	\$150M	\$6M	-96%
Cash and Investments:	\$295M	\$167M	-43%
<b><u>ITC-Deltacom</u></b>			
<i>Filed: Aug-01   Emerged: TBD</i>			
Total Indebtedness:	\$724M	\$194M	-73%
Annual Interest Expense:	\$60M	\$12M	-80%
Cash and Investments:	\$23M	NAV	



## *Proposed Solutions – Stabilize Network Economics*

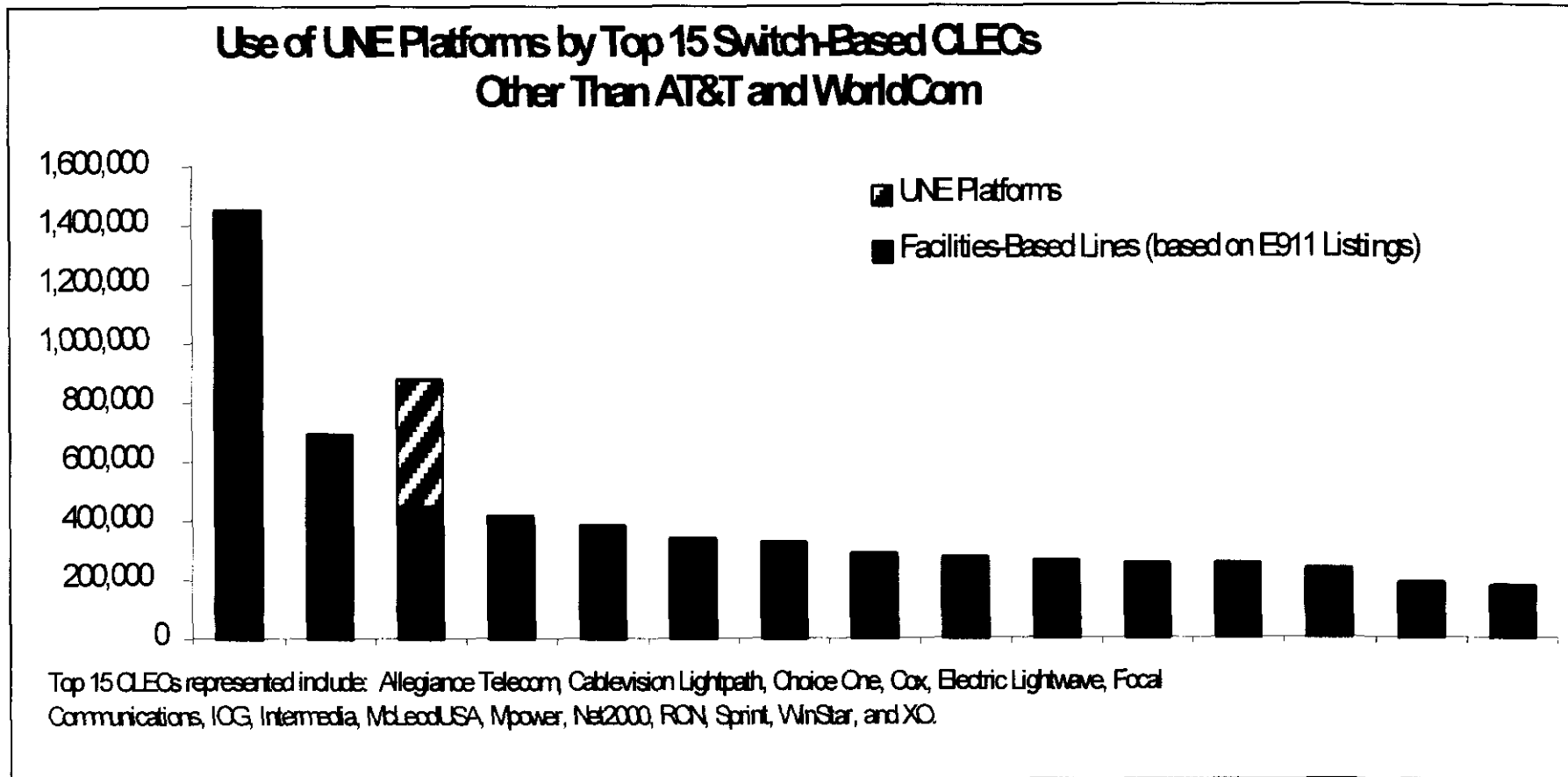
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### ■ FCC can help stabilize network economics by:

- Limiting the number of UNEs available at TELRIC, especially switching and transport
- Act quickly on Triennial review
- Adopt policies that encourage investment
  - Broadband NPRM
  - TimeWarner/BellSouth framework
- Adopt policies that reward sound financial management
  - Approve deposit tariffs
  - Avoid actions that reward bankruptcy and fraud

## ***Proposed Solutions – Stabilize Network Economics - Eliminate UNE-P at Telric***

- Other than AT&T and WorldCom, the 15 largest CLECs that have deployed switches make virtually no use of UNE-P



Source: Based on E911 listings

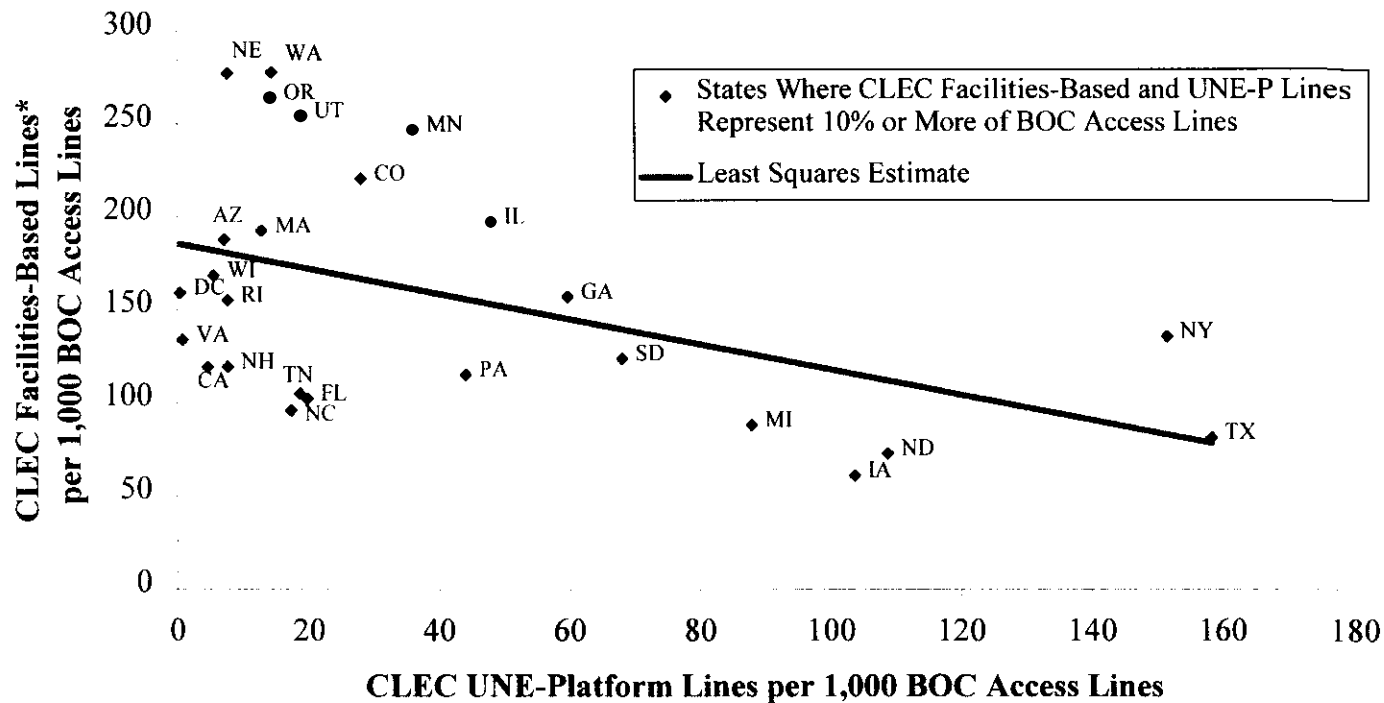
Fact Report reference: p. I-9

## *Proposed Solutions – Stabilize Network Economics - Eliminate UNE-P at Telric*

### **The Availability of UNE P Decreases the Level of Facilities-Based Competition**

- Data from all states with significant CLEC entry demonstrate that the availability of the UNE-P decreases the level of facilities-based competition.

**Figure 1. Facilities-Based Competition Decreases as UNE-P Penetration Increases**



\*Facilities-based lines are based on CLEC E911 listings as of year-end 2001.

## ***Proposed Solutions – Stabilize Network Economics - Eliminate UNE-P at Telric***

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### **Proposed Solution – Eliminate UNE-P Telric**

- In New York, AT&T and WorldCom together provide UNE-P service to over 1M residential customers
- AT&T and WorldCom operate 28 local circuit switches in New York
- Yet the two companies have converted virtually none of these UNE-P customers to service utilizing their own switches
- Arbitrage opportunities are too rich to encourage new investment or even use of existing investment

Fact Report reference: pp. 11-18-19

## ***Proposed Solution – Stabilize Network Economics***

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- **While UNE-P does nothing to create sustained investment in Competitive networks, it does create huge concerns about the financial viability of the ILEC.**

### **Recent Analysts comments:**

#### **Deresdener Kleinworth Wassatein\***

“From an macroeconomic point of view there are general concerns with the UNE-P system:

- It's a policy-stimulated transfer of wealth (from shareholders and employees to consumers), rather than being left to market forces.
- In the longer-term it could rob consumers of advanced services that require the RBOC's plentiful cash flow to fund.
- Asset write-downs will cause “stock-shock” and a shock to the telecom “supplier system.”

\* UNE-P: The Un-Profitable RBOC (August 9, 2002)

## ***Proposed Solution – Stabilize Network Economics***

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### **Recent Analysts comments: (continued)**

#### **UBS Warburg\***

“Economics of UNE-P are Worse than we Originally Expected.

- UNE-P lines generate negative EBITDA in 18 States for the Bells (60% of US residential lines)  
    . . . . .
- Long Distance Opportunity is only a Partial Offset
  - Bells only need to add 1.3 Long Distance Customers for each UNE-P line added to break even at revenue line.
  - However, the Bells need to add 5.4 Long Distance Customers for each UNE-P line added to break even at EBITDA line.
  - “UNE-P IS AN EBITDA STORY, NOT A REVENUE STORY”

#### **Solomon Smith Barney\*\***

- “From a Bell perspective, as we’ve written many times over the past several months, this is a nightmare. They get half the revenue with the same cost.”

\* The Regional Bells: How Much Pain from UNE-P

\*\* SBC Communications Report (July 23, 2002)

# ***Proposed Solution – Stabilize Network Economics***

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## **Recent Analysts comments: (continued)**

### **Commerce Capital Markets\***

- “For the CLECs, the lower UNE rates present the opportunity to enter the local market with minimal up-front investment.
- From the RBOC – investor’s perspective UNEP presents several problems. One is the reduction in revenues that comes from converting retail to wholesale revenues. The other is the pricing compression that comes from the RBOC’s an attempt to restructure their prices to compete with new entrants. Finally, there is the exposure during a period when an RBOC cannot yet enter long-distance, but the IXC’s have begun to enter its local market.”

### **Percursor Group\***

- “There is a “telecom debt spiral” where over-capacity is not getting worked out of the system, but comes back less leveraged and on competitive steroids. The trends toward data and wireless present profit-challenged growth; and regulator-priced “competition” continues to deflate profits.”

\* The States of 271 and UNE-Platform in the Regional Bell Territories (August 22, 2002)

\*\* Percursor Investment Perspective (April 3, 2002)

## ***Proposed Solution – Stabilize Network Economics***

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**Eliminate transport as UNE (unnecessary for competition) and continue special access protections.**

### **Special Access Facts**

- 1985 – Teleport Provides Transport Services for special access to business customers in NY
- 1986 – 16 States authorize special access competition
- 1995 – 29 CAPS serve 100 cities with 21K fiber route miles
- 2001 – 1800 networks serve 70% of US population, 150 largest MSAs. 91/100 top MSAs served by 3 networks, 77 by 7, 59 by > 10.

Source – UNE Fact Report 2002, p.K-1



## *Proposed Solutions – Stabilize Network Economics*

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